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IN THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES.

Docket No. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR
VARIANCE OF CERTAIN REQUIREMENTS
OF A.A.C. 4-14-2-1606

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING THE
ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC
COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC POWER
COMPETITION RULES COMPLIANCE
DATES

ISSUES IN THE MATTER OF TUCSON
ELECTRIC POWER COMPANY'S
APPLICATION FOR A VARIANCE OF
CERTAIN ELECTRIC COMPETITION RULES
COMPLIANCE DATES

Docket No. E01933A-02-0069

NOTICE OF FILING TESTIMONY

Pursuant to Third Procedural Order on Track B (dated October 9, 2002), Tucson Electric Power Company ("TEP"), through undersigned counsel, provides notice that it has filed the Direct Testimony of David Hutchens regarding Track B Issues, a copy of which is attached.

RESPECTFULLY SUBMITTED this 12th day of November, 2002.

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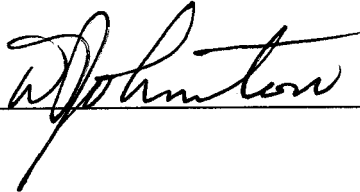
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IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING ELECTRIC
RESTRUCTURING ISSUES.

Docket No. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR
VARIANCE OF CERTAIN REQUIREMENTS
OF A.A.C. 4-14-2-1606

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC
PROCEEDINGS CONCERNING THE
ARIZONA INDEPENDENT SCHEDULING
ADMINISTRATOR

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC
COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC POWER
COMPETITION RULES COMPLIANCE
DATES

Docket No. E-01933A-98-0471

ISSUES IN THE MATTER OF TUCSON
ELECTRIC POWER COMPANY'S
APPLICATION FOR A VARIANCE OF
CERTAIN ELECTRIC COMPETITION RULES
COMPLIANCE DATES

Docket No. E01933A-02-0069

DIRECT TESTIMONY OF DAVID HUTCHENS

ON BEHALF OF

TUCSON ELECTRIC POWER COMPANY

RE: TRACK B ISSUES

NOVEMBER 12, 2002

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1 WITNESS BACKGROUND

2 Q: Please state your name and employment position.

3 A: My name is David Hutchens. I am Manager of Wholesale Marketing for Tucson Electric
4 Power Company.

5 Q: What are your job responsibilities at Tucson Electric?

6 A: I oversee the Wholesale Marketing department functions, including wholesale gas and
7 electricity procurement, resource management, risk management, marketing, scheduling
8 and trading.

9 Q: What has been your involvement in the Track B proceedings?

10 A: I have represented TEP in every workshop and submitted testimony on TEP's needs
11 assessment and procurement proposal.

12 Q: What is the purpose of your testimony?

13 A: Pursuant to the "Third Procedural Order on Track B Issues," in Docket E-00000A-02-
14 0051 *et al.*, parties, including TEP, "shall file testimony and associated exhibits on the
15 Track B issues identified by the parties" and a "response to the Staff Report" by 12:00
16 p.m. on November 12, 2002. This testimony will provide that information.

17 Q: How is your testimony structured?

18 A: It addresses five topics: (i) the unique circumstances concerning TEP's participation in
19 the competitive solicitation process; (ii) comments on TEP's unresolved Track B issues;
20 (iii) comments on Staff's Track B Report (dated October 25, 2002); (iv) TEP's comments
21 on two Track B issues raised by other parties; and (v) TEP's key recommendations
22 concerning modifications to the solicitation process outlined in the October 25 Staff
23 Report.

24 SUMMARY

25 Q: Please summarize your testimony.

26 A: TEP's position on the proposed competitive solicitation process is driven by the unique
27 circumstance that TEP believes deserve consideration in the solicitation process. The

1 two key facts underlying TEP's positions are: (i) TEP does not have any competitive
2 affiliates that will participate in the solicitation process and (ii) the TEP retail service area
3 faces significant transmission limitations that may affect TEP's competitive solicitation.
4 However, although the Commission Staff's October 25, 2002 Report contains many valid
5 conclusions that TEP fully supports, it fails to recognize TEP's unique position and
6 places uneconomic and unnecessary requirements on TEP. Moreover, those detrimental
7 requirements provide no benefit to other parties. TEP proposes two key modifications to
8 Staff's solicitation proposal to remedy TEP's concerns: (i) allowing TEP's wholesale
9 marketing department to conduct the competitive solicitation, thus avoiding the need to
10 create a duplicate, parallel department and (ii) allowing TEP to include all TEP
11 generation assets existing as of September 1, 2002 in the determination of TEP's
12 Contestable Load, not just assets "included in rate base."

13 TEP'S UNIQUE CIRCUMSTANCES

14 Q: What was the overriding concern throughout the Track B workshops?

15 A: The majority of the workshop discussion centered around insuring that Pinnacle West
16 would not be given any advantage over the other generators bidding into the solicitation
17 process, particularly given that it appeared that the vast majority of available contestable
18 load would be APS load. Thus, many of the proposed requirements that have been
19 included in Staff's proposed solicitation process were designed to specifically address the
20 issue of APS having an affiliate, Pinnacle West, with generation resources that would be
21 bidding into the solicitation. However, several of those general requirements create an
22 unnecessary burden on TEP given the difference between TEP and APS.

23 Q: What are the circumstances unique to TEP that should be noted in the development of the
24 Competitive Solicitation Process?

25 A: There are three important, unique circumstances: (i) TEP has no affiliate involved in the
26 marketing and trading of wholesale power; (ii) TEP has no generation affiliate that will
27 be bidding into the 2003 solicitation; and (iii) TEP has different transmission concerns
28 for delivery of energy to its load area.

1 Q: How does the absence of a TEP affiliate involved in the generation, marketing and
2 trading of wholesale power bidding into the solicitation process affect the process design?

3 A: TEP understands that Decision No. 65154 seeks to increase the competitiveness of the
4 wholesale electricity markets in Arizona by insuring all future needs are met through
5 competitive processes. However, even without the proposed competitive solicitation
6 process being developed in Track B, TEP currently procures all of its "required power
7 that cannot be produced from its own existing assets"¹ from unaffiliated third parties in
8 the wholesale market, as is now required by that Decision. Thus, TEP feels that it
9 already meets the spirit of Decision No. 65154 pertaining to the procurement of power
10 that cannot be produced from TEP's existing generation assets. It is only the requirement
11 that TEP use a specific solicitation process to procure that "required power" that will
12 create any change in TEP's resource management functions. To the extent the process is
13 being designed to avoid unfair competitive advantage by UDC affiliates, the lack of any
14 TEP affiliate obviates such concerns. The imposition on TEP of requirements focused on
15 eliminating unfair advantages for affiliates simply imposes an unnecessary burden on
16 TEP without any corresponding benefits.

17 Q: What specific transmission concerns exist for TEP's service area that need to be
18 addressed?

19 A: All of TEP's retail load is contained within a load pocket as identified by ACC Staff in its
20 Biennial Transmission Assessment. As such, this load can only be served through a
21 combination of (i) remote generation brought in over existing transmission facilities and
22 (ii) local generation resources owned and operated by TEP within the load pocket. Since
23 the late 1970's when TEP began participation in remote generation resources to obtain
24 economies of scale through regional resource development, as well as to reduce its
25 dependence on oil and gas generation, TEP has planned and developed its load serving
26 capabilities through a balanced mix of remote generation, local generation and
27 transmission additions that would be most economical and reliable for serving its
28 customers. That goal of achieving an optimal mix led TEP to install gas combustion

¹ ACC Decision No. 65154, p. 33.

1 turbines ("CTs") in 2001 to provide the required voltage support capability at peak load
2 conditions. Under current Commission terminology these local units are referred to as
3 Reliability Must-Run ("RMR") units. These units (and other TEP RMR units) have been
4 considerably more cost effective than constructing a major transmission project to
5 provide additional import capability. Moreover, constructing additional transmission
6 facilities would have created excess transmission capacity not needed to serve the peak
7 load. This excess capacity would be idle and provide no benefit to TEP or its customers.
8 Further, TEP presently controls very little available transmission capacity ("ATC") to
9 transmit power from remote interconnection points into TEP's service territory.

10 Q: Does the location of the new merchant generation plants provide specific challenges?

11 A: Yes. The majority of the new merchant plants are located where there is no Firm ATC for
12 delivery to TEP's retail service area. Some plants are able to reach TEP's service area
13 but require multiple wheels from transmission providers resulting in uneconomic
14 alternatives when compared to the cost of TEP's own generating resources.

15 Q: How are these transmission constraints being remedied?

16 A: TEP is assessing options to improve import capability into TEP's retail service area. TEP
17 is working with merchants and other utilities to define other transmission bottlenecks and
18 using the Central Arizona Transmission Study ("CATS") process to plan additional
19 transmission upgrades accordingly. However, this is a long-term process and the
20 permitting and construction phases for new lines will put any line addition several years
21 out.

22 COMMENTS ON TEP'S UNRESOLVED ISSUES

23 Q: What were TEP's unresolved issues listed in its October 1, 2002 filing?

24 A: TEP listed two primary unresolved issues that it would like to address. The first is the
25 amount of TEP's Contestable load and the second is the involvement of TEP's marketing
26 employees in the solicitation process. As more fully explained in my November 4, 2002
27 Needs Assessment testimony, TEP was under the impression that these issues were
28 agreed upon by all parties participating in the workshops.

1 Q: If TEP felt that its contestable load was agreed to in the workshops, why did TEP list it as
2 an unresolved issue?

3 A: The agreement was basically a settlement of three related issues: (i) the inclusion of
4 TEP's new RMR CTs in its existing assets; (ii) the inclusion of TEP's wholesale load in
5 its contestable load calculation; and (iii) the ability of TEP's Wholesale Marketing
6 department to conduct TEP's solicitation. TEP listed the issue as unresolved in order to
7 be able to address the issue in front of the Commission in the event that resolution of any
8 of the three terms changed. As noted in my November 4, 2002 testimony, Staff's report
9 reversed the resolution of two of the three issues leaving only the inclusion of TEP's
10 wholesale load intact.

11 Q: Why does TEP request that its Wholesale Marketing department be allowed to conduct
12 the solicitation?

13 A: As discussed in my November 4, 2002 testimony, in light of the absence of any TEP
14 affiliate that could be involved in the process and the fact that the TEP procurement
15 functions currently fall into this group's purview, the requirement to prohibit this group
16 from participating would disadvantage TEP and impose an uneconomic and unnecessary
17 consequence on TEP.

18 Q: How would this disadvantage TEP and impose such burdens?

19 A: TEP's Wholesale Marketing department manages TEP's load and resources. In that
20 capacity, it performs the procurement of electricity and fuel by evaluating the operational
21 and economic terms of such procurement. While at times the economic evaluation can be
22 fairly straightforward, it often involves complex products that require detailed modeling
23 and market analysis. Further, the operational requirements of TEP's load and resources
24 require detailed and specific knowledge. It is TEP's Wholesale Marketing department
25 that has this knowledge and therefore the best ability to evaluate TEP's needs and assess
26 the solicitation options. If TEP must use others for this evaluation, TEP would lose this
27 critical knowledge and would incur increased (and unnecessary) costs by creating a
28 duplicate department that would be conducting the same analyses and tasks. Given the
29 lack of any TEP affiliate, the apparent prohibition on TEP's Wholesale Marketing

1 department provides no benefit to the process whatsoever and makes no sense. It should
2 be noted that no party to the workshops contested TEP's recommendation that its
3 wholesale group be allowed to conduct the solicitation process. Indeed, it appeared that
4 the recommendation was unanimously agreed upon.

5 Q: How does this change on the role of TEP's Wholesale Marketing department affect
6 TEP's position on its amount of Contestable Load?

7 A: If the other two issues are resolved to TEP's satisfaction – specifically that TEP's two
8 newest RMR CTs are included in its existing assets and TEP's Wholesale Marketing
9 department can conduct the solicitation – TEP will continue to include its wholesale load
10 in calculating its contestable load and commit to the capacity and energy quantities
11 provided in the workshops. Absent a favorable resolution of these issues for TEP, TEP
12 will take the position that its unmet needs should not be calculated including FERC
13 jurisdictional Market-Based Tariff Wholesale Agreements.

14 Q: Does the inclusion of TEP's wholesale load in calculating its unmet needs infer any
15 future rate-making treatment of the energy purchased in the solicitation?

16 A: No. The inclusion of the wholesale load was discussed in the workshops as a way to
17 address the existence of TEP wholesale contracts and to provide TEP with some amount
18 of load to bid in the solicitation process. Even though the wholesale load is under TEP's
19 market-based tariff – and *not* under a cost of service tariff – it was Staff's position that if
20 TEP did not include its wholesale load, Staff would contend that an equal amount of
21 TEP's existing generation assets should be set aside and not included in calculating
22 unmet needs – even though Decision No. 65154 contemplated that such assets should be
23 included in the contestable load calculation. The resulting unmet need is the same
24 regardless of whether wholesale load is included or an equal amount of existing
25 generation is excluded. In a spirit of compromise and for ease of computation, TEP
26 agreed to the inclusion of wholesale load. The fact that TEP's market-based wholesale
27 contracts were not moved to an affiliate should not unfairly disadvantage TEP.

28 Q: Does the inclusion of TEP's wholesale load in calculating its unmet needs infer the
29 inclusion of this or new wholesale load in future solicitations?

1 A: No. Its inclusion would represent a settlement for the 2003 solicitation. TEP has to be
2 able to manage its wholesale business under traditional jurisdictional processes.
3 Specifically, it cannot effectively manage its wholesale business if it is saddled with
4 additional, non-jurisdictional procurement requirements. TEP further understands Staff's
5 position that this process will most likely change and evolve before the next solicitation is
6 undertaken.

7 **COMMENTS ON STAFF REPORT**

8 Q: What are TEP's comments on the October 25, 2002 Staff Report in this docket?

9 A: TEP generally agrees with the solicitation process set forth in that report. TEP has
10 already expressed its disagreements on the Staff's position concerning TEP's contestable
11 load and the exclusion of TEP's Wholesale Marketing department from the solicitation
12 process, both above and in my November 4, 2002 testimony in this docket. I will not
13 repeat all of TEP's position here. However, there are a few additional portions of the
14 Staff Report that TEP would like to address further.

15 Q: Should utilities be given the latitude to reject any or all bids in the solicitation process?

16 A: Yes. The purchasing utilities must be given the flexibility to reject any or all bids that do
17 not meet its economic or reliability criteria. Without such ability, the utility would be put
18 at a grave disadvantage to the bidders. The Staff agrees: "The solicitation materials will
19 contain the terms and conditions proposed by the utility, including the right of the utility
20 to reject all bids and to amend the request for service without notice" [October 25, 2000
21 Staff Report, p. 16:14], as does APS [Testimony of Thomas Carlson (dated November 4,
22 2002), pp. 10:13, 15:22].

23 Q: Does TEP agree with Staff's position on p. 4:16 that the "process itself had to be flexible
24 enough to allow purchasing utilities and selling merchants the latitude to structure the
25 terms and conditions under which service would be provided in a manner that made
26 economic, operational and regulatory sense"?

1 A: Yes. TEP strongly agrees with this explicit statement made by Staff and Staff's position
2 throughout the workshop process that the solicitation would not impose uneconomic
3 requirements on the utilities.

4 Q: Does the current structure of the solicitation process in Staff's report provide the
5 flexibility and latitude referenced?

6 A: For the most part it does. TEP agrees with the general structure and direction of the
7 solicitation process defined in Staff's report but feels that the requirement that all its
8 unmet needs be met through one particular process at one instance in time unnecessarily
9 removes some of that flexibility and management's business discretion.

10 Q: What is TEP's position on Staff's recommendation [p. 4:25] that "short-term power and
11 daily, weekly or monthly power acquired to meet unplanned needs, would however
12 continue to be purchased in the normal course of business as it is today"?

13 A: TEP strongly agrees with this position. It is an obvious necessity that the utility be
14 afforded discretion to enter into short-term transactions. As Staff recognizes, this gives
15 the utility the opportunity to economically displace plant or contract energy with cheaper
16 market power or purchase to cover unplanned needs arising from temperature extremes
17 and unplanned generation or transmission outages without jeopardizing system reliability
18 by being unnecessarily burdened with a cumbersome procurement process. It is again
19 important to point out that any such purchase that TEP would make in this timeframe
20 would be from unaffiliated third parties.

21 Q: Does TEP agree with Staff's "Scope of 2003 Solicitation" on p. 6 of the Staff Report?

22 A: No. Staff has defined contestable load (*i.e.*, the amount to be bid in the solicitation) as
23 "all load and energy requirements not served by generation owned by the utility and
24 included in the utility's rate base as of September 1, 2002" or by "power supplied
25 pursuant to FERC or Commission approved contracts."² In the workshops, Staff and the
26 other parties explicitly agreed to TEP's recommendation to modify this phrase from
27 Staff's draft report to include generation leased by the utility and to strike the reference to

² October 25, 2002 Staff Report, p. 6.

1 rate base. The result was defining the contestable load as "all load and energy
2 requirements not served by generation owned or leased by the utility as of September 1,
3 2002" or by "power supplied pursuant to FERC or Commission approved contracts."
4 TEP believes that revision meets the letter of Decision No. 65154 and should be adopted
5 by the Commission.

6 Q: What is TEP's view of Staff's recommended "Price to Beat?"

7 A: TEP recognizes that the desired result is an expedited prudence review given that
8 contracts entered into are priced below this metric. While TEP believes that the
9 recommended structure may deter long-term contracts by requiring an additional discount
10 to the price to beat, this issue has been somewhat mitigated by Staff's recognition that
11 contracts which do not meet the price to beat standards "will not automatically be viewed
12 by Staff as unreasonable or imprudent" but rather require that they "will need to be
13 evaluated by Staff in subsequent proceedings." [October 25, 2002 Staff Report, p. 26:9-
14 12]

15 Q: What is TEP's position on Qualifying Facility ("QF") contracts not being subject to
16 competitive solicitation?

17 A: Again, this was discussed, albeit briefly, in one of the workshops. It was mentioned that
18 a very large merchant generation project had filed for QF status and the parties present at
19 the workshop generally agreed that QF contracts started after September 1, 2002 would
20 be subject to the competitive solicitation process. However, TEP understands that Staff
21 may not have wanted this to be such a general and exclusive requirement given that other,
22 legitimate QFs may surface in the future which should be excluded from the competitive
23 bid process. Given that Staff and the Commission have ultimate oversight over both the
24 QF and Solicitation processes, TEP is comfortable with the language in Staff's Report.

25 Q: What are TEP's views of the process timeline?

26 A: The timeline is aggressive given the number of responsibilities and obligations placed on
27 the utilities. TEP recognizes this and has already started to collect its data and set up a
28 solicitation website so that it can provide information to bidders – as early as possible and
29 solicit input on contract structure, product definition, etc. It is imperative that all the

1 parties to the process work together to insure timely collection and dissemination of data
2 to be able to meet the deadlines set in Staff's proposal.

3 Q: Is an independent monitor needed for TEP's solicitation?

4 A: While TEP recognizes that Staff and other parties may desire an independent monitor to
5 assist them in evaluating the bids and insure the integrity of the process, this comes at the
6 cost of a bid fee. Given TEP's unique circumstances discussed above regarding the lack
7 of an affiliate – and if Staff and the other parties agree – TEP believes that the bidding fee
8 and monitor requirement could be waived for bids to TEP.

9 Q: How are the contracts entered into in this solicitation treated in future solicitations?

10 A: The Staff report is silent on this issue but TEP believes that it must be explicitly stated
11 and understood that any contract entered into in this solicitation process would be
12 considered an existing asset and therefore not be contestable in later solicitations if it has
13 not expired.

14 **COMMENTS ON OTHER PARTIES' UNRESOLVED ISSUES**

15 Q: Does TEP have any comments on unresolved issues raised by other parties?

16 A: Yes, there are a couple of key issues that TEP would like to address at this point.

17 Q: Should bids be selected on a least-cost basis and include longer term bids in the process?

18 A: Yes. However, in order to determine least-cost alternatives in a competitive bid process,
19 it is imperative that *all* "costs" be evaluated including, but not limited to, contractual
20 performance metrics, credit, delivery, risk management and contract remedies. Longer-
21 term agreements should be considered, at the utility's discretion, in the process to enable
22 necessary transmission infrastructure to be built and to insure that the output from power
23 plants located in Arizona stays in Arizona to meet its growing demand.

24 Q: How should the "Commission Approval" process and cost-recovery mechanism be
25 addressed?

26 A: TEP believes that the Commission approval process and cost-recovery mechanism for
27 purchases made under the solicitation process be addressed in these hearings. It is critical

1 that the utility knows what the approval process will be at the beginning of the process
2 because it will affect procurement decisions and other issues in the proceeding. The
3 Commission approval process should provide a specific timeline for contract approval
4 and the ability of the utility to reject accepted bids if the Commission does not find those
5 contracts reasonable and prudent. The shorter the time period for Commission approval,
6 the less risk premium sellers will build into their prices. The cost-recovery mechanism
7 for all contracts entered into in the solicitation process should be clearly in the record of
8 these proceedings and insure that the utility is afforded the opportunity to recover all
9 costs associated with the contracts and the process.

10 TEP'S RECOMMENDATIONS

11 Q: Given TEP's position on the unresolved issues, does TEP have a recommendation that
12 addresses its unique circumstances while still maintaining the integrity of the general
13 proceeding in this docket?

14 A: Although TEP has commented on a variety of issues in this testimony, two minor
15 modifications to the October 25, 2002 Staff Report will address TEP's primary concerns.
16 In fact, these modifications were already agreed to in the workshop process with respect
17 to TEP given its unique circumstances. TEP believes that it has presented compelling
18 evidence of those circumstances and that the requested modifications are justified.
19 Therefore, TEP recommends waivers be granted TEP for the 2003 Solicitation as
20 follows:

- 21 1. With respect to the "Scope of 2003 Solicitation" in the Staff
22 Report, with respect to TEP, the Commission should delete p. 6:5-
23 18 and replace it with "For 2003, TEP's solicitation will be for all
24 retail and wholesale load and energy requirements not served by
25 generation owned or leased by the utility as of September 1, 2002
26 or by power supplied pursuant to FERC or Commission approved
27 contracts with affiliated and non-affiliated suppliers entered into
28 prior to September 1, 2002. To the extent that affiliated suppliers
29 provide service pursuant to contracts dated on or after September
30 1, 2002, such service will be subject to competitive solicitation.

1 To the extent that load is served pursuant to capacity or energy
2 contracts with Qualifying Facilities or Environmental Portfolio
3 Standard requirements, that load will also not be contestable. All
4 demand-side management commitments in place as of September
5 1, 2002, shall be considered in determining contestable load.”

6 2. Waive the applicability of Section IV. C, paragraph 1 [lines 10-19]
7 of the Staff Report with respect to TEP, thus allowing TEP’s
8 Wholesale Marketing department to be involved in the solicitation
9 process.

10 Q: Does this conclude your testimony?

11 A: Yes.